(3) Section 1.3(b) of this title defines *investment security* to exclude securities ''which are predominantly speculative in nature'', so that, under R.S. 5136 and the regulation, the purchase of *predominantly speculative* securities is not permissible. When the market price of a convertible debenture is far in excess of its face value because of the conversion feature, and its price fluctuations parallel the fluctuations in the price of the stock into which it is convertible, the debenture is necessarily speculative. Market conditions may induce price fluctuations that may have no relationship to the quality of the debenture or even of the particular stock into which it can be converted.

(4) Accordingly, it would appear that a bank is prohibited from purchasing convertible debentures in the circumstances described. However, uncertainty as to this matter could arise from the terms of §1.10 of this title (Comptroller's Revised Regulation), which might be read as indicating that a bank may purchase convertible securities generally, provided that the cost of such a security is written down promptly ''to an amount which represents the investment value of the security considered independently of the conversion feature''.

(5) Quite apart from questions of interpretation of the revised regulation, however, it is to be noted that the law itself (paragraph Seventh of R.S. 5136) in effect forbids national banks and member State banks to purchase ''any shares of stock of any corporation''. When the market price of a convertible security reaches 200 percent or 300 percent of its face value due to a rise in the price of the related stock, purchase of the convertible security is, for practical purposes, equivalent to the purchase of the stock it represents.

(6) In the light of these statutory and regulatory provisions, it is the position of the Board of Governors that a member State bank may not lawfully invest in a convertible security whose price exceeds, by more than an insignificant amount, the investment value of the obligation, considered independently of the conversion feature. Adherence to this principle will avoid violations of the statute and regulation that would occur if a bank were to purchase convertible securities in such circumstances that the security necessarily would be ''predominantly speculative in nature'', for the reasons described, and the transaction would be tantamount to a purchase of corporate stock.

(12 U.S.C. 24, 335)

§ 250.122 Underwriting of public Authority bonds payable from rents under lease with governmental entity having general taxing powers.

(a) The Board of Governors has been asked whether securities of a public Authority that are to be paid from rents payable under a lease of the Authority's facilities to a governmental entity that possesses general powers of taxation, including property taxation, constitute ''general obligations'' within the meaning of section 5136 of the U.S. Revised Statutes (12 U.S.C. 24). In cases where this question can be answered in the affirmative, member State banks of the Federal Reserve System may lawfully underwrite and deal in such securities, and invest therein without limitation on amount, as far as Federal banking law is concerned.

(b) The Board understands that the issuing Authorities usually have no taxing powers and that their obligations are not, under pertinent State constitutional and statutory provisions as interpreted by the courts, ''debt'' of the lessee—that is, the governmental entity with general powers of taxation. However, whether a security constitutes a *debt* for purposes of State law is not determinative as to whether it is a *general obligation* within the meaning of section 5136, a Federal statute. (See §250.120.)

(c) During recent Hearings before the Committee on Banking and Currency of the House of Representatives, published under the title ''Increased Flexibility for Financial Institutions—1963'', the Board expressed its understanding of the meaning of the phrase ''general obligations of any State or of any political subdivision thereof'' as used in section 5136.

(d) As the House Committee was informed, the Board understands that phrase to include ''only obligations that are supported by an unconditional

promise to pay, directly or indirectly, an aggregate amount which (together with any other funds available for the purpose) will suffice to discharge, when due, all interest on and principal of such obligations, which promise (1) is made by a governmental entity that possesses general powers of taxation, including property taxation, and (2) pledges or otherwise commits the full faith and credit of said promisor; said term does not include obligations not so supported that are to be repaid only from specified sources such as the income from designated facilities or the proceeds of designated taxes.'' (Hearings, p. 1018.)

(e) A major requirement of the foregoing definition is that a *general obligation* must be supported by general powers of taxation, including property taxation. The Board recognizes, however, that such support by general powers of taxation may be indirect as well as direct.

(f) If a State (or other governmental entity having general powers of taxation) agrees unconditionally to pay to an Authority rentals that will be sufficient and will be used, in all events, to cover required payments of interest and principal on the relevant securities when due, the securities, in the opinion of the Board, are indirectly supported by general taxing powers, and, accordingly, constitute *general obligations* within the meaning of R.S. 5136. On the other hand, if the lease does not contain an unconditional promise of the State to provide sums sufficient, in all events, to cover required payments of interest and principal on the bonds of the lessor Authority as they become due, the securities cannot be considered *general obligations.*

(g) The status of a particular issue of such lease-supported bonds thus depends upon the terms of the lease involved. Where the lease is for a term of years not less than the maximum maturity of the relevant bond issue, and the State unconditionally promises to pay rentals sufficient to cover all payments on the bonds as they become due, the bonds ordinarily will qualify as *general obligations.* Where the promise of the State is to pay a fixed dollar rental, the securities will not qualify as *general obligations* unless the lease provides that rental payments in amounts sufficient to service the bonds cannot be expended by the authority for any other purpose than the payment of principal and interest thereon.

(h) This interpretation is intended to indicate the circumstances in which securities issued by public Authorities without taxing powers constitute *general obligations* that are eligible for underwriting by member banks, under R.S. 5136. The status of any particular issue can only be determined through examination of all relevant laws and contracts, in order to ascertain the actual legal and financial arrangements.

(12 U.S.C. 24, 335)

§ 250.123 Underwriting of notes payable from proceeds of subsequent sale of general obligation bonds.

(a) The Board of Governors has received inquiries whether California Bond Anticipation Notes constitute *general obligations* of the State of California within the meaning of paragraph Seventh of section 5136 of the U.S. Revised Statutes (12 U.S.C. 24).

(b) The Board understands that, in anticipation of the sale of general obligation bonds duly authorized, Finance Committees of certain public authorities of the State are empowered, under section 16736 of the Government Code of California, to direct the State Treasurer to issue Bond Anticipation Notes whenever ''the committee deems it in the best interests of the State''.

(c) Although there appears to be no judicial decision as to the nature of Bond Anticipation Notes under California law, the State Attorney General has issued an opinion (No. 63/182 of Nov. 8, 1963) concluding that the Notes do not constitute ''a general obligation of the State in the sense that they are secured by the State General Fund and general taxing power of the State''.

(d) While the California Attorney General's opinion is not controlling in a determination as to whether the Notes are *general obligations* within the meaning of section 5136, a Federal statute, it is significant in such a determination insofar as it indicates that the Notes are not secured by the State's ''general powers of taxation, including property taxation'', a sine qua